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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)

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FURTHER COMMENTS OF THE WESTERN ALLIANCE

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SUMMARY

As the questions appended to the July 3 Notice show, the complexities of implementing the universal service provisions of the 1996 Act¹ make it increasingly apparent that a “one-size-fits-all” approach will be unmanageable and contrary to the public interest. Notably, for larger carriers and their customers, proxy cost models may prove workable and sufficient to achieve the congressional mandate of affordable service for all Americans, both urban and rural. For small high-cost carriers serving remote and insular areas, however, adoption of any of the proxy models proposed so far will cause hardship and will fail to achieve the intent of Congress. If the Commission concludes that proxy models will serve the public interest in some areas and for some groups of customers, therefore, the Commission should adopt proxy-based rules only for carriers serving more than 50,000 access lines. This bifurcated approach will institute a new universal service system for the overwhelming majority of local service subscribers, while preserving the cost-based system that remains the most appropriate approach for rural, insular and high-cost ratepayers.

¹ Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56 (“1996 Act”), to be codified at 47 U.S.C. Secs. 151 et seq.

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The Western Alliance¹ submits the following further comments in response to the questions appended to the Public Notice, "Common Carrier Bureau Seeks Further Comment on Specific Questions in Universal Service Notice of Proposed Rulemaking," released July 3, 1996.

Responses to Questions

Definitions Issues

1. Is it appropriate to assume that current rates for services included within the definition of universal service are affordable, despite variations among companies and service areas?
2. To what extent should non-rate factors, such as subscribership level, telephone expenditures as a percentage of income, cost of living, or local calling area be considered in determining the affordability and reasonable comparability of rates?

Response to Questions 1 and 2. The rates for the local nontoll services that fit the current definition of universal service are generally perceived by ratepayers as affordable.

¹ The Western Alliance is a consortium of the Western Rural Telephone Association and the Rocky Mountain Telecommunications Association, representing approximately 300 exchange carriers serving the 23 states west of the Mississippi River and the island territories of the Pacific Rim. The Alliance's membership consists almost entirely of small carriers, many serving fewer than 1,000 customers dispersed over large, remote service areas.

In many rural and high-cost areas, however, the flat rates charged for local services are only part of the cost incurred by ratepayers to reach destinations within their local communities of interest. So, for example, a rural subscriber may pay only \$10 per month for local, flat-rate calling, but may pay twice that or more per month for short-haul toll calls to the nearest schools, hospitals, local government offices and other destinations that an urban customer would reach through flat-rate calling. An adequate definition of basic service would include all calls within a subscriber's community of interest, and an adequate definition of affordability would include the cost of all such calls, as well.

The problem of subscribership in rural areas suggests that the present Lifeline program is not reaching the neediest rural residents. The Western Alliance believes that the definition of affordable service should take into account subscribership and income, and that support for affordable service for low-income subscribers should be achieved through a more adequate Lifeline program. The Western Alliance does not, however, support the inclusion of income levels in the formula for calculation of high-cost assistance. Preserving the distinction between support programs based on subscriber plant costs, and support programs based on individual need, will avoid undue complexity, confusion and possible dilution of the effectiveness of both types of programs.

Schools, Libraries, Health Care Providers

6. Should the services or functionalities eligible for discounts be specifically limited and identified, or should the discount apply to all available services?

Response to Question 6. Specific functionalities eligible for discounts should be identified. The Western Alliance urges that only the more expensive services be eligible for discounts. These services would include full motion video, data switching (frame

relay or ATM), and higher bandwidth lease lines such as DS3s for data. More common services such as switched voice service, voice mail services and others should not be provided on a discounted basis, but should continue to be part of the regular budget of the entities.

7. Does Section 254(h) contemplate that inside wiring or other internal connections to classrooms may be eligible for universal service support of telecommunications services provided to schools and libraries? If so, what is the estimated cost of the inside wiring and other internal connections?

Response to Question 7. It is unlikely that such support will be required. The Western Alliance member companies have found that teachers, administrators and parents can successfully install inside wiring and other internal classroom connections. Where advice and guidance are needed, our member companies provide those services at nominal cost.

14. If the discounts are disbursed as block grants to states or as direct billing credits for schools, libraries, and health care providers, what, if any, measures should be implemented to assure that the funds allocated for discounts are used for their intended purposes?

Response to Question 14. These grants must be audited regularly by a certified public accounting firm, and the discount should be applied to tariffed rates and/or rates determined through competitive bidding. Common carriers should be allowed to bid using a "special assembly" tariff.

21. Should the Commission use a sliding scale approach (i.e., along a continuum of need) or a step approach (e.g., the Lifeline assistance program or the national school lunch program) to allocate any additional consideration given to schools and libraries located in rural, insular, high-cost and economically disadvantaged areas?

Response to Question 21. The Western Alliance believes that a sliding scale approach will produce a more equitable result

22. Should separate funding mechanisms be established for schools and libraries and for rural health care providers?

Response to Question 22. Yes, a separate funding mechanism should be established. Schools and libraries are governmental entities and rural health care is generally provided through the private sector. We believe the incompatibility between these delivery systems justifies separate funding.

24. Are there other cost estimates available that can serve as the basis for establishing funding estimate for the discount provisions applicable to schools and libraries and to rural health care providers?

25. Are there any specific cost estimates that address the discount funding estimates for eligible private schools?

Response to Questions 24 and 25. These questions cannot be meaningfully answered until the Joint Board and FCC have ascertained the services to be provided under the discount program. Once those services have been identified, some of the demonstration projects previously funded by the NTIA and RUS may provide useful information. Similarly, requests for RUS grants already pending, suitably adjusted, may furnish a reasonable estimate of the pent-up demand that a discount program would need to accommodate.

Any estimates of the scope of the discount program also must reflect choices concerning technology. ISDN, for example, is a relatively low-cost technology for rural areas, followed by T1 transport technology. If the program is to support full-motion video, however, considerably more expensive DS3 technology may be required. A cost-

benefit analysis might show ISDN video, followed by fractional television technology, to be more cost-effective than DS3 transport.

High Cost Fund

General Questions

26. If the existing high-cost support mechanism remains in place (on either a permanent or temporary basis), what modifications, if any, are required to comply with the Telecommunications Act of 1996?

Response to Question 26. None.

27. If the high-cost support system is kept in place for rural areas, how should it be modified to target the fund better and consistently with the Telecommunications Act of 1996?

Response to Question 27. The fund is adequately targeted in rural areas today.

No commenter, in this or any other proceeding, has demonstrated that the high-cost fund has led to abuse or inefficiency by rural telephone companies.

28. What are the potential advantages and disadvantages of basing the payments to competitive carriers on the book costs of the incumbent local exchange carrier operating in the same service area?

Response to Question 28. The Western Alliance believes that supports for smaller carriers -- whether they are incumbents or new entrants -- should be based on actual costs. There is no reason to assume, however, that the book costs of incumbent carriers are a guide to the costs incurred by new, competing carriers, who lack the investment obligations imposed on established telephone companies as carriers of last resort. New entrants wishing to participate in the universal service system should assume the full panoply of universal service obligations, and should comply with cost reporting requirements from which their eligibility for high-cost support can accurately be determined.

31. If a bifurcated plan that would allow the use of book costs (instead of proxy costs) were used for rural companies, how should rural companies be defined?

Response to Question 31. For this purpose rural companies should be defined as those carriers that are too small for proxy costs to be meaningfully applied. Because of the widely varying circumstances of individual companies, no precise, completely reliable threshold for this determination can be identified; but the Western Alliance believes that proxy approaches should not be applied to any company serving fewer than 50,000 access lines that also meets the criteria for "rural telephone company" adopted by the Congress in the Telecommunications Act of 1996.² A bifurcated approach that applied proxies only to companies above this threshold would avoid causing hardship to rural ratepayers and would comport with the universal service goals embodied in the 1996 Act.

32. If such a bifurcated approach is used, should those carriers initially allowed to use book costs eventually transition to a proxy system or a system of competitive bidding? If these companies are transitioned from book costs, how long should the transition be? What would be the basis for high-cost assistance to competitors under a bifurcated approach, both initially and during a transition period?

² 47 U.S.C. Sec. 153(37). In this connection, the Western Alliance notes Chairman Hundt's recent suggestion that new approaches to calculation of the fund might be applied exclusively -- or at least initially -- to the "95% of Americans served by large carriers." Speech of Reed Hundt, Chairman, Federal Communications Commission to the Joint Meeting of the Great Lakes Conference of Public Utilities Commissioners and Mid-Atlantic Conference of Regulatory Commissioners, July 8, 1996 (prepared text at 9). By the Western Alliance's calculation, if one begins with the smallest local telephone company in the United States -- measured in numbers of access lines in use -- and adds the access lines served by that company to the number of access lines served by the next smallest company, and continues the process until 5% of the access lines in the U.S. are accounted for, the largest company in this group serves fewer than 50,000 access lines. In other words, the Western Alliance's proposed, 50,000 access line threshold comports closely with Chairman Hundt's view that revised universal service rules might apply, at least initially, to the "large carriers" that serve 95% of the nation's ratepayers.

Response to Question 32. No proxy method yet proposed will offer a meaningful substitute for book costs as a means of calculating high-cost supports for which small, rural and insular companies may be eligible.³ Accordingly, companies initially subject to book costs under a bifurcated approach should convert to proxy treatment only if changes in their size and the character of their service areas, or further refinement of the proxy models, make the proxy approach appropriate for those companies. And even after a company qualifies for proxy treatment, the Commission should establish a procedure for prompt consideration of waiver requests from companies that are prepared to demonstrate that the proxy model does not accurately reflect the cost of serving their ratepayers.

Finally, if the Commission chooses to subject small, rural companies to a proxy model or competitive bidding after a period of transition, the transition period should at least match the repayment schedules of the loans the rural companies have with the Rural Utilities Service, COBank, and Rural Telephone Finance Cooperative, and/or the depreciation periods established by the local public service commission. These loan repayment and depreciation schedules are based on the continued availability of high-cost support based on actual costs, and premature implementation of proxies would jeopardize the viability of rural companies and their ability to meet these commitments.

High-cost assistance to new local exchange service providers should be based on actual costs. Where new carriers agree to assume universal service obligations and seek inclusion in the universal service system, the Commission should impose appropriate cost

³ As to the appropriateness of competitive bidding, see Responses to Questions 49 and 51-55, infra.

reporting requirements from which their eligibility for high-cost supports can be determined.

33. If a proxy model is used, should carriers serving areas with subscription below a certain level continue to receive assistance at levels currently produced under the HCF and DEM weighting subsidies?

Response to Question 33. Whether supports are based on proxies or book costs, high-cost support for small, rural carriers should continue at levels comparable to those of the current HCF and DEM weighting programs, regardless of subscribership levels. Calculation of support under these programs for rural telephone companies serving fewer than 50,000 access lines should continue to be based on book costs rather than proxies.

Proxy Models

The Western Alliance recognizes that in order to designate, and calculate support for, eligible telecommunications carriers under the 1996 Act,⁴ it may be necessary to disaggregate cost information presently maintained on a study area basis into smaller units such as wire centers or Census Block Groups. Disaggregation, however, does not require the adoption of proxy mechanisms, and the Western Alliance continues to oppose the application of proxy models to small, rural telephone companies. The Alliance's opposition is based on close study of the models proposed so far, the comments and information filed in this rulemaking, and participation in industry efforts to refine those models. Familiarity with those efforts has caused the Alliance to reach the following conclusions.

⁴ 47 U.S.C. Sec. 214(e)(2).

First, even those most familiar with the proxy models -- their authors and proponents -- caution that those models may work substantial hardship to smaller companies, and recommend their application only to larger companies.⁵ Some proponents, in fact, go so far as to recommend that proxies only be used with price cap carriers -- a category that excludes a number of urbanized telephone service areas.⁶

Second, the assumptions and data in the proxy models lump together small companies displaying widely different cost structures. So, for example, the BCM2 model assumes uniform distribution of population at any level of population density -- an assumption wildly at odds with many, and perhaps most, real-world service areas. Similarly, the BCM2 treats all Census Block Groups below five households per square mile the same, ignoring the wide variations in cost within this range, in which the smallest, highest-cost companies are disproportionately represented.⁷ Finally, the models do not account for differences in vintages of subscriber plant within companies, even though the average age and amortization of equipment may be drastically different from one small company to another.

Third, intensive discussions of the existing models within the industry have failed to secure agreement on the most basic assumptions, and still have

⁵ See, e.g., Comments of NYNEX at 10 ("The [Benchmark Cost Model] should only be used to calculate support amounts for price cap (i.e. large) LECs [because] such a model may not accurately portray the costs of a carrier that serves only a limited or smaller area, and thus could cause financial harm to small carriers.") See also MCI Comments at 11; Comments of US West, Inc. at 9; Comments of US West Communications, Inc. in CC Docket 80-286 at 26

⁶ See, e.g., Comments of NYNEX, supra at 10

⁷ See Reply Comments of the Rural Telephone Coalition, n. 33 at 10.

failed to produce reliable data. While considerable refinement of these models may be achieved in the coming months and years, progress to date does not justify application of these models to any but large, nonrural companies. Premature application of these models to rural carriers will lead to unfair -- even confiscatory -- results.

34. What, if any, programs (in addition to those aimed at high-cost areas) are needed to ensure that insular areas have affordable telecommunications service?

Response to Question 34.

To the extent the question is confined to true island areas, the Western Alliance believes that existing support mechanisms are adequate for all high-cost areas, whether or not those areas are insular

On the more general question of the adequacy of existing programs for high-cost areas, the Western Alliance notes that many states may require customers to pay construction charges if they live too far from the present backbone telecommunication facilities. These construction charges are a barrier to subscribership and should be eliminated throughout the country if adequate support can be provided through a high cost fund. There are many areas of the country that nearby LECs are unwilling to serve because of the high cost. These areas need to be reviewed to find out why they are not being served even though the present universal service fund is meant to provide service to these regions.

35. US West has stated that an industry task force "could develop a final model process utilizing consensus model assumptions and input data." US West comments at 10. Comment on US West's statement, discussing potential legal issues and practical considerations in light of the requirement under the 1996 Act

that the Commission take final action in this proceeding within six months of the Joint's Board's recommended decision.

Response to Question 35. The Western Alliance has participated in the NECA Mayflower Group, the NECA Proxy Group and the USTA Proxy Group, and believes that US West has overstated the potential for consensus within these groups. Participants in these discussions continue to disagree concerning the computational model to be adopted and the criteria that a successful model will meet.

36. What proposals, if any, have been considered by interested parties to harmonize the differences among the various proxy cost proposals? What results have been achieved?

Response to Question 36. Attempts have been made to cure the deficiencies of individual models by combining their stronger features, but no such model has demonstrated accurate results when applied to smaller, rural carriers. Participants still are unable to secure accurate data or agree as to the features of a model that will yield meaningful results.

37. How does a proxy model determine costs for providing only the defined universal service core services?

Response to Question 37. This question cannot be answered until a method is found for generating accurate, total company results on a proxy basis. Once such a model is available, the method of generating results for particular services or groups of services can be explored.

38. How should a proxy model evolve to account for changes in the definition of core services or in the technical capabilities of various types of facilities?

Response to Question 38. See Response to Question 37.

40. If a proxy model is used, what, if any, measures are necessary to assure that urban rates and rates in rural, insular, and high-cost areas are reasonably comparable, as required in Section 254(b)(3) of the 1996 Act?

Response to Question 40. Intrastate rate relationships should remain an area of state responsibility, subject to the requirements of the 1996 Act.

41. How should support be calculated for those areas (e.g., insular areas and Alaska) that are not included under the proxy model?

Response to Question 41. Support for companies not included in the proxy model should be calculated according to the present rules

42. Will support calculated using a proxy model provide sufficient incentive to support infrastructure development and maintain quality service?

Response to Question 42. The proxy models presently under consideration will not provide rural companies with sufficient incentives to maintain, expand and modernize their infrastructures. Under the present system, infrastructure investment is reflected in USF settlements after two years. In the BCM2 and other proposed proxy models, infrastructure investment is not directly reflected in increased funding.

45. Is it appropriate for a proxy model adopted by the Commission in this proceeding to be subject to proprietary restrictions, or must such a model be a public document?

46. Should a proxy model be adopted if it is based on proprietary data that may not be available for public review?

Response to Questions 45-46. Use of proprietary data may be essential to the development of accurate proxy data, and such proprietary information must enjoy appropriate protection. The Commission should consider this question in the context of the pending inquiry concerning the Commission's treatment of proprietary and competitively sensitive information.

Competitive Bidding

49. How would high-cost payments be determined under a system of competitive bidding in areas with no competition?

Response to Question 49. The Western Alliance strongly questions the ability of *any* system of competitive bidding to serve the public interest and achieve the universal service goals of the 1996 Act.

One difficulty with competitive bidding is the inability of even the best-informed, most conscientious bidder to anticipate the cost of providing universal service. For example, under today's rules, if a company's subscriber loop cost is greater than twice the nationwide average, the local jurisdiction will receive a local rate requirement somewhere between 160 and 170% of the nationwide average. If the support for universal service is reduced for this carrier, the local rate requirement will of course move above 160% of the nationwide average. Under these circumstances, assume that a new entrant bids for universal service support in the belief that its average loop cost will be three times the national average, then receives a request for service from a customer who will impose service costs of 14 times the national average. Unless the new entrant is adding a sufficient number of low-cost customers to offset the costs that the new customer would impose, the temptation to deny service to the more costly customer will be strong. As this example demonstrates, competitive bidding, however great its theoretical appeal, will not solve the long term universal service problem.

51. What, if any, safeguards should be adopted to ensure that large companies do not bid excessively low to drive out competition?

Response to Question 51. The Commission might consider application of a proxy model to set a lower limit of reasonableness for universal service bids. Such a model, however, could do no more than screen some of the more irresponsible bids. It could not

correct for the inherent, and ultimately fatal, weaknesses of competitive bidding in the universal service context. (See Response to Question 49.)

52. What safeguards should be adopted to ensure adequate quality of service under a system of competitive bidding?

Response to Question 52. See Response to Question 51. Ultimately, no regulatory safeguards can ensure, in advance, that a new entrant to a rural service area will provide adequate quality of service.

53. How is collusion avoided when using a competitive bid?

Response to Question 53. Reasonable auction procedures, such as those adopted by the FCC in the PCS spectrum auctions, will minimize opportunities for collusive bidding. No system, however, can entirely prevent such practices.

54. Should the structure of the auction differ if there are few bidders? If so, how?

Response to Question 54. If the number of bidders is inadequate to ensure a meaningful auction, then the auction should not be held and the incumbent should remain the only carrier eligible for universal service supports. Competitive bidding only has meaning if there is a sufficiently large pool of bidders who can play an active role in the bidding process. One needs a pool of competitive bidders, perhaps 20 in size with at least 5 bidding in each round, if the process is to produce a meaningful result.

55. How should the Commission determine the size of the areas within which eligible carriers bid for universal service support? What is the optimal basis for determining the size of those areas, in order to avoid unfair advantage for either the incumbent local exchange carriers or competitive carriers?

Response to Question 55. If competitive bidding is instituted the 3% most rural companies should not be included in the process

Benchmark Cost Model (BCM)

56. How do the book costs of incumbent local exchange carriers compare with the calculated proxy costs of the Benchmark Cost Model (BCM) for the same areas?

Response to Question 56. As a number of commenters in this proceeding have demonstrated, proxy models produce results that are comprehensively inaccurate, even for large companies.⁸ While larger, price-cap companies can average the effects of these systematic inaccuracies over a wide range of service environments, smaller companies have no such opportunity. Accordingly, proxies should at most be applied as part of a system of bifurcated regulation, under which companies serving fewer than 50,000 access lines continue to receive supports based on actual costs.

SLC/CCLC

69. If a portion of the CCL charge represents a subsidy to support universal service, what is the total amount of the subsidy? Please provide supporting evidence to substantiate such estimates. Supporting evidence should indicate the cost methodology used to estimate the magnitude of the subsidy (e.g., long-run incremental, short-run incremental, fully-distributed).

Response to Question 69. A minimum of 2.2 billion dollars of high cost support is contained with the CCL charges. This amount represents the differential between the \$6 SLC originally proposed by the Commission, and the \$3.50 SLC ultimately adopted for residential access lines. The total urban to rural subsidy is between 8 and 10 billion dollars.⁹ It is our understanding that a carrier common line charge of \$5 per access line would cover the total CCL subsidy. A USTA proposal appears to have made that

⁸ Comments of Southwestern Bell Telephone Company at 14-16.

⁹ MCI's estimates, using the Hatfield Model, give this figure. Preliminary NECA calculations under the BCM2 Model, however, yield an expense adjustment at the Census Block Group level of \$6.963 billion.

calculation. However, there is in many states a comparable SLC associated with carrier common line charges, so that the true value of a SLC would most likely be substantially higher: for example, in the \$10 range in Arkansas, and in the \$14 range in Alaska.

Low-Income Consumers

71. Should the new universal service fund provide support for the Lifeline and Linkup programs, in order to make those subsidies technologically and competitively neutral? If so, should the amount of the lifeline subsidy still be tied, as it is now, to the amount of the subscriber line charge?

Response to Question 71. As noted in the Responses to Questions 1 and 2, some accommodation should be made in the Lifeline program for short haul toll charges in rural, insular and high-cost areas.

Administration of Universal Service Support

72. Section 254(d) of the 1996 Act provides that the Commission may exempt carriers from contributing to the support of universal service if their contribution would be de minimis." The conference report indicates that "[t]he conferees intend that this authority would only be used in cases where the administrative cost of collecting contributions from a carrier or carriers would exceed the contributions selected by the Commission." What levels of administrative costs should be expected per carrier under the various methods that have been proposed funding (e.g., gross revenues net of payments to other carriers, retail revenues, etc.)?

Response to Question 72. The collection of funds from carriers should not be a major problem. Each carrier should be responsible for hiring certified public accounting firms to prepare audits regarding their revenues and the amount of money owed by such carriers would be based on these CPA reports. Companies not able to provide these reports should not participate in any universal service funding program.

Respectfully submitted,

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August 2, 1996

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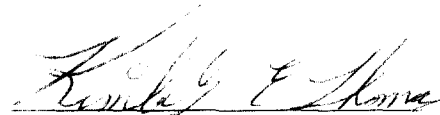
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